



## **The Emergence of Islamic Financing Based on the Syariah Concept of Tawarruq**

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For decades, banks and financial institutions in Malaysia extensively used the traditional *Syariah* concepts of *Bai' Bithaman Ajil* (BBA) and *Bai' al-Inah* in Islamic financing. The starting of operations of foreign Islamic banks in Malaysia looks set to change this trend.

*Bai' Bithaman Ajil* (BBA) is a contract of sale and purchase of an asset in which the payment of price (which includes profit) is deferred and paid in instalments within an agreed period of time. As practised in Malaysia, there is another contract which precedes this contract, i.e., the sale by the owner of the asset (customer) to the purchaser at a price which is equivalent to the financing amount. This has attracted criticism from many quarters who hold the view that it resembles the *Bai' al-Inah* concept which opens the back door to *riba* (*hiyalah ila riba*)\*.

*Bai' al-Inah* is mainly used in Malaysia for a contract of sale and purchase of an asset whereby the seller (the bank) sells to the buyer (customer) the asset at a deferred price and subsequently buys back at a lower price. The majority of Islamic jurists are of the view that the contract of *Bai' al-Inah* is not valid as it is considered as a legal device in order to overcome the prohibition of *riba*, as the motive behind the sale is to get a loan (financing amount) with interest (profit).

However, *Syafii* jurists (whose view Malaysian scholars follow) are of the view that such sale is valid by the external evidence that it is properly concluded and fulfilled the requirements of a valid sale: the unlawful intention of the parties is immaterial, it does not invalidate their act, unless expressed in that act (*nahkum bizzawahir wallahu yatawallassorair*).

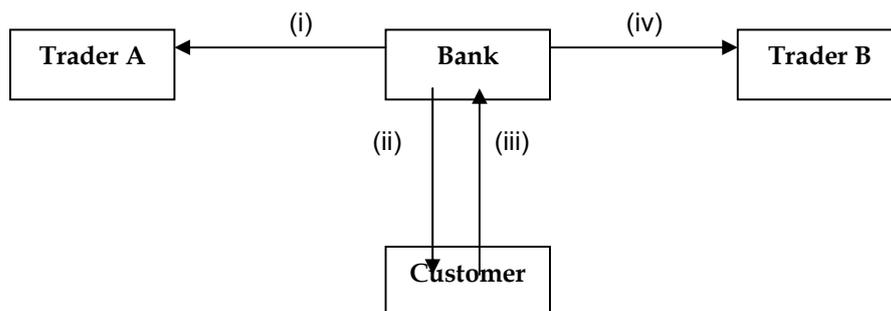
In order to avoid criticism on Islamic financing in Malaysia and to attract foreign customers, many new *Syariah* concepts, like the concepts of *Musyarakah Mutanaqisah* (diminishing *Musyarakah*) and *Tawarruq*, have been introduced in Malaysia. This development coincides with the move by Bank Negara (the Central Bank of Malaysia) to grant licenses to 3 foreign Islamic banks, Kuwait Finance House (M) Bhd, Al Rajhi Banking & Investment Corporation (Malaysia) Berhad and Asian Finance Bank Berhad to commence their banking operations in Malaysia.

One of the new *Syariah* concepts introduced is the concept of *Tawarruq*. The *Syariah* Advisory Council of Bank Negara Malaysia in its 51<sup>st</sup> meeting held on 28<sup>th</sup> July 2005/21<sup>st</sup> *Jamadi* Akhir 1426 resolved that deposit product and financing based on the concept of *Tawarruq* which is known as commodity *Murabahah* is permissible.

*Tawarruq* is defined as an arrangement that involves a purchase of an asset based on *Musawamah* (price agreed through bargaining) or *Murabahah* and a subsequent sale of the same asset to a third party in order to gain cash money.

It differs from *Bai' Bithaman Ajil* (BBA) as commonly practiced in Malaysia and *Bai' al-Inah* as *Tawarruq* involves a third party, and in *Tawarruq* transactions there is no condition for the underlying sale object to be returned back (resold) to the original owner (first seller).

A simple mechanism in a *Tawarruq* financing is illustrated below:



Note:

- (i) the bank purchases commodity from trader A in the commodity market on cash basis;
- (ii) thereafter, the bank sells the commodity to the customer on deferred price (cost price plus profit margin);
- (iii) the customer may appoint the bank as his agent to sell the commodity to trader B on cash basis in the commodity market; and
- (iv) the bank then sells the commodity, as agent of the customer, to trader B on cash basis in the commodity market.

The emergence of the *Syariah* concept of *Tawarruq* marks a new era of Islamic financing in Malaysia. It is also consistent with Malaysia's aim to promote the Malaysia International Islamic Financial Centre (MIFC) which offers Islamic financial products which are acceptable globally.

\*Usury/unfair profit.